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Swallows Holding as It Is: The Distortion of National Muffler

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special report

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In *Swallows Holding Ltd. v. Commissioner*, a reviewed opinion in early 2006, the Tax Court invalidated a regulation involving return filing by certain foreign corporations. The case is now on appeal to the Third Circuit. Johnson believes that the Tax Court's decision is wrong because it misread the precedents on which it relied and misperceived the roles of Treasury and the courts in filling gaps Congress left in tax statutes.

In this article, Johnson maintains that the Tax Court misapplied the standard on which it relied: the *National Muffler* line of cases on deference to tax rules and regulations. In a planned future article, Johnson will maintain that the Tax Court failed to appreciate the teaching of the Supreme Court in the *Chevron* and *Brand X* cases. According to Johnson, either on *National Muffler* grounds or on *Chevron* and *Brand X* grounds, the *Swallows Holding* decision should be reversed.

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I like big ideas. The opportunity to work with them, and hopefully to add to them, is one of the joys of academic life. But perspective also is required. Not everything genuinely presents "macro" issues.[1] As Freud supposedly said, "Sometimes a cigar is just a cigar."

In *Swallows Holding Ltd. v. Commissioner*,[2] the Tax Court, over three dissenting opinions, invalidated a return-filing timing rule in a Treasury regulation under section 882 of the IRC. It is clear that what drove the majority opinion was the perception that the timing rule was contrary to many previous cases interpreting the statute.[3] As I read the majority and dissenting opinions, the prospect of writing about great issues danced in my head: matters such as (1) the relationship between *Chevron*[4] and competing standards of deference,[5] and (2) the significance for tax law of the Supreme Court's *Brand X* decision,[6] dealing with when administrative rules may displace prior case law.

However, when I read the cases on which the *Swallows* majority relied, the need for a "plan B" became apparent.

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[1]As the Supreme Court has warned in the context of statutory interpretation, one should avoid the temptation to find "elephants in mouseholes." *Whitman v. American Trucking Ass'n, Inc.*, 531 U.S. 457, 468 (2001).

[2]126 T.C. 96, *Doc 2006-1541, 2006 TNT 18-10* (2006). On July 5, 2006, the IRS filed its notice of appeal in this case to the Third Circuit.

[3]*See id.* at 137 (denouncing Treasury's promulgating the regulation "with total disregard to firmly established judicial precedent") and 148 (objecting to Treasury's "attempts to circumvent longstanding judicial decisions").

[4]*Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

[5]Judge Mark V. Holmes was thinking along those lines, too. His dissent offered the hope that the case may "be a good vehicle for appellate guidance on whether *National Muffler* continues to be in good working order after *Chevron*, *Mead*, and *Brand X*." *Id.* at 163-164.

[6]*National Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 125 S. Ct. 2688 (2005).

When those cases are carefully analyzed, the perceived tension between them and the regulation disappears. Indeed, understood in the context of the proper roles of the courts and Treasury, the cases actually support the validity of the regulation. As a result, *Swallows* does not present the "regulation versus case law" conflict that would sharpen *Brand X* and *Chevron* issues. Yet *Swallows* remains an interesting and important case,[7] particularly because, in my opinion, the *Swallows* majority distorted the *National Muffler*[8] standard, converting it from a shield of deference to a sword of invalidation.

Accordingly, I will write two *Swallows* reports. This report, the first, treats the decision as it is. It explains why, given the compatibility of the regulation and the prior cases, *Swallows* was wrongly decided and should be reversed. This article also attempts to bring *National Muffler* back from the diversion it was taken on by *Swallows*. A future article will treat *Swallows* not as it is but as the Tax Court majority viewed it. That is, the second article will assume that the regulation is inconsistent with the prior cases. That assumption will allow exploration of *Chevron* and *Brand X* issues.

This article has five main parts. Part I describes *Swallows*. The case for reversal of *Swallows* rests on propositions which are developed in Parts II, III, IV, and V. Part II shows that, properly understood, the previous cases held that some timing requirement for the filing of returns is implicit in the governing statute. Therefore, the only question is one of line-drawing: where to draw the line between permissibly tardy returns and impermissibly tardy returns.

Part III notes that Congress did not instruct where the timing line was to be drawn. It left a gap to be filled. Line-drawing under an implicit delegation is a matter for Treasury and the IRS, not for the courts. Part IV demonstrates that the line drawn by the regulation is reasonable. It effectively furthers the purpose behind the statute; it responds to a genuine need in the orderly administration of the tax laws; and it is indulgent toward, not burdensome for, taxpayers. All that being so, the regulation at issue should be upheld.

Part V particularizes the analysis under *National Muffler* and the other cases of its line. Part V establishes that, although that line of cases is deferential toward tax regulations, the approach of the *Swallows* majority was closer to a hard look than to deference. When *National Muffler* is properly applied deferentially, upholding the regulation should not be problematic.

I. *Swallows*

A. Facts

The taxpayer was a foreign corporation that owned real property in the United States. The corporation was on a fiscal year ending on May 31. The tax years at issue were 1994, 1995, and 1996. The due dates for those returns were November 15 of 1994, 1995, and 1996, respectively.[9] The corporation did not file those returns until July 23, 1999. However, the corporation had not been contacted by the IRS about the delinquent returns, nor had the IRS prepared substitutes for those returns. The corporation was treated as having elected to treat its U.S.-source income as effectively connected with a U.S. trade or business.[10] The corporation's deductions for the years at issue substantially exceeded its income. The IRS disallowed the claimed deductions and asserted deficiencies. The corporation filed a Tax Court petition.

Section 882(c)(2) provides that a foreign corporation with effectively connected income can claim deductions "only by filing . . . a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the [IRS] may deem necessary for the calculation of such deductions." That requirement entered the law in 1928 and has been reenacted many times without essential change.[11] Subtitle F contains the procedural sections of the code, including section 6072, which prescribes when income tax returns are to be filed.

Regulations were promulgated in 1957, nearly 30 years after enactment of the original predecessor of section 882. The regulations were amended in 1990 and again in 2002 and 2003.[12] The timing rule at issue in *Swallows* emanated from the 1990 amendments. Those amendments were first proposed in July 1989[13] and were finalized in December 1990, effective for tax years ending after July 31, 1990.[14] Before being finalized, the amendments went through the familiar notice-and-comment process.[15]

The 1990 amendments set out timing rules for foreign corporations in reg. section 1.882-4 and broadly similar

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[7]Commentary about *Swallows* thus far includes Jasper L. Cummings, Jr., "Tax Court Decision Demonstrates Uncertainty in Standard of Review for Interpretive Versus Legislative Regulations," 25 *Tax Man. Weekly Rep.* 585 (2006); Craig W. Friedrich, "Late Filing Foreign Corporation Does Not Forfeit Deductions; Contrary Regulation Invalidated," *Corp. Tax'n*, May/June 2006, at 44; Richard M. Lipton, "A Divided Tax Court Rejects a Regulation — and Struggles With Administrative Law — in *Swallows Holding*," 104 *J. Tax'n* 260 (2006); Kathryn J. Morrison, "Are Timely Filed Returns a Prerequisite for Foreign Corporation Expense Deductions?" *ABA Section of Taxation NewsQuarterly*, Summer 2006, at 9; W. Eugene Seago and Edward J. Schnee, "The Tax Court Salvages a Foreign Corporation's Deductions in *Swallows Holding*," *Corp. Tax'n*, May/June 2006, at 20; Lee A. Sheppard, "Tax Court Flunks the *Brand X* Test," *Tax Notes*, Feb. 6, 2006, p. 585.

[8]*National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979).

[9]Usually, a corporation must file its income tax return by the 15th day of the third month after the close of its tax year. Section 6072(b); reg. section 1.6072-(a). However, foreign corporations without an office or place of business in the United States (such as the *Swallows* taxpayer) may file up to the 15th day of the sixth month after the close of the year. Section 6072(c); reg. section 1.6072-2(b).

[10]126 T.C. at 97; *see* section 882(d)(1).

[11]The statutory history is recounted at 126 T.C. at 107-111.

[12]The regulatory history is recounted in *id.* at 125-129.

[13]54 *Fed. Reg.* 31545 (July 31, 1989).

[14]T.D. 8322, 1990-2 C.B. 172, 55 *Fed. Reg.* 50827-01 (Dec. 11, 1990), *corrected at* 56 *Fed. Reg.* 1361-01 (Jan. 14, 1991) and 56 *Fed. Reg.* 5455-07 (Feb. 11, 1991).

[15]*See* proc. reg. section 601.601; IRM 30(15) and 32.1.5.

timing rules for nonresident alien individuals in reg. section 1.874-1. Under the amended regulation, a foreign corporation may avail itself of otherwise allowable deductions and credits for the year only if it files its federal income tax return by a specified time.[16]

The rules defining the specified date or terminal date include complexities and special rules unnecessary to explore for *Swallows* purposes.[17] In general, and as applicable to the *Swallows* taxpayer, for the corporation to be allowed deductions, "the required return for the current taxable year must be filed within 18 months of the due date as set forth in section 6072 and the regulations under that section, for filing the return for the current taxable year."[18] For simplicity, I use the 18-month terminal date throughout this article. It was the failure of the *Swallows* taxpayer to file its 1994, 1995, and 1996 returns within the 18-month period that prompted the IRS to disallow the deductions claimed for those years.

Finally, as relevant here, the 1990 regulation allows the IRS to waive the 18-month requirement for good cause, based on the facts and circumstances, if shown by the foreign corporation.[19] It does not appear that the *Swallows* taxpayer sought this waiver.

The taxpayer challenged the validity of the regulation, leading to review by the full Tax Court.[20] The majority opinion, invalidating the 18-month time limit in the regulation, was authored by Judge David Laro, with 12 judges joining in the opinion and 2 judges concurring in the result only. Judges Stephen J. Swift, James S. Halpern, and Mark V. Holmes wrote dissenting opinions.

B. Majority Opinion

Because the regulation in question was promulgated under the general authority of section 7805(a) and not under specific authority in section 882 itself, the regulation is an interpretive regulation. At least in theory, interpretive regulations receive less deference than legislative regulations.[21] The *Swallows* majority identified *National Muffler* as the standard by which to assess the validity of interpretive tax regulations.[22] In general, a regulation is valid under that standard if it implements Congress's intention in a reasonable manner, that is, if it "harmonizes with the plain language of the statute, its origin, and its purpose."[23]

The majority focused on six factors drawn from *National Muffler*: whether the regulation was substantially contemporaneous with the statute, the manner in which the regulation evolved, whether the regulation is of long standing, reliance placed on the regulation, the consistency of the IRS's interpretation, and how much scrutiny Congress gave the regulation during subsequent reenactments.[24]

The majority concluded that the regulation failed under those factors. For this article's purposes, two aspects of the majority's analysis are particularly noteworthy: (1) the majority's "plain language" argument based on prior cases construing the statute, and (2) the majority's "legislative reenactment" argument.

First, the majority stated: "A plain reading of the relevant text [of section 882(c)(2)] in the context of the . . . Code shows that the text includes no timely filing requirement."[25] The statute does make filing a return "in the manner prescribed by Subtitle F" a condition for allowance of deductions. However, the majority held that the "plain meaning of the word 'manner,' as used in the relevant text, does not include an element of time."[26] Thus, when the regulation added a timing rule as to returns, it impermissibly went beyond the statute.

Central to the majority's "plain meaning" argument were the prior cases involving section 882(c)(2), substantially similar section 874(a),[27] and their predecessors. The first case of this line was the Board of Tax Appeals' (BTA's) 1938 *Anglo-American* decision.[28] The line included eight other cases that were decided between 1939 and 1996.[29] The *Swallows* majority believed the regulation to

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[16]Reg. section 1.882-4(a)(2).

[17]For a full statement of the rules, see reg. section 1.882-4(a)(3); *see also* 126 T.C. at 135 n.17 (majority opinion) and 151-153 (Swift, J., dissenting).

[18]Reg. section 1.882-4(a)(3)(i). If no return has been filed for the year immediately preceding the current year, the terminal date is 18 months after the due date of the current year's return or the date the IRS "mails a notice to the foreign corporation advising the corporation that the current year tax return has not been filed and that no deductions . . . may be claimed by the taxpayer." *Id.*

[19]Reg. section 1.882-4(a)(3)(ii).

[20]For description of the Tax Court's conference and review procedures, see Harold Dubroff, *The United States Tax Court: An Historical Analysis* 352-360 (1979). Invalidation of a treasury regulation is one of the situations that customarily triggers full-court review by the Tax Court.

[21]*See, e.g., Rowan Cos., Inc. v. Commissioner*, 452 U.S. 247, 253 (1981). I say "in theory" because it is unclear that this difference operates in fact, not just in rhetoric. This point will be explored in the second article.

[22]126 T.C. at 129-131. The majority added, however, that the result it reached would have been the same had it applied *Chevron* instead of *National Muffler*. *Id.* at 131.

[23]440 U.S. at 476-477.

[24]126 T.C. at 136-137 (*citing* 440 U.S. at 477).

[25]126 T.C. at 132.

[26]*Id.*

[27]In relevant respects, the section 874 rules as to nonresident alien individuals parallel the section 884 rules concerning foreign corporations, including conditioning deductions on properly filed returns. Accordingly, the two sections are viewed as *in pari materia*. *E.g., id.* at 112; *Espinosa v. Commissioner*, 107 T.C. 146, 153, *Doc 96-26161, 96 TNT 188-4* (1996).

[28]*Anglo-Am. Direct Tea Trading Co., Ltd. v. Commissioner*, 38 B.T.A. 711 (1938). The IRS issued a nonacquiescence to *Anglo-American*. 1939-1 C.B. (pt. 1) 39.

[29]The cases are *Mills, Spence & Co. v. Commissioner*, 1938 WL 8403 (B.T.A. memo. 1938); *American Inv. & Gen. Trust & Co. v. Commissioner*, 1939 WL 12004 (B.T.A. memo. 1939); *Taylor Sec., Inc. v. Commissioner*, 40 B.T.A. 696 (1939); *Ardbern Co. v. Commissioner*, 120 F.2d 424 (4th Cir. 1941), *modifying and remanding on other grounds*, 41 B.T.A. 910 (1940); *Blenheim Co. v. Commissioner*, 125 F.2d 906 (4th Cir. 1942), *aff'g* 42 B.T.A. 1248 (1940); *Gordon Enter. v. Commissioner*, 126 F.2d 384 (4th Cir. 1942), *aff'g* 1940 WL 10265 (B.T.A. memo. 1940); *Espinosa v. Commissioner*, 107 T.C. 146 (1996); *InverWorld, Inc. v. Commissioner*, T.C. Memo. 1996-301, 71

(Footnote continued on next page.)

be inconsistent with those cases, although it did not explain the perceived inconsistency with particularity. I read the prior cases differently, as will be seen in Part II.

The other noteworthy aspect of the majority opinion is its invocation of the legislative reenactment doctrine. Citing cases, the majority summarized the doctrine thusly: "Congress is presumed to have known of the administrative and judicial interpretations of a statutory term reenacted without significant change and to have ratified and included that interpretation in the reenacted term."[30] Congress had reenacted, without essential change, section 882 and its predecessors several times after *Anglo-American* was decided. On that basis, the majority concluded that Congress approved of that case and the cases that came after it.

C. Dissenting Opinions

I will recount only the portions of the dissents relevant to this article. Judge Swift thought the prior cases were distinguishable because the 1990 regulation was not at play in them.[31] Thus, "the majority opinion fails to properly distinguish the pre-1990 'no-regulation environment' of the cited court opinions from the environment or authority that came into existence upon promulgation [of the regulation] in 1990."[32]

Judge Holmes challenged the majority's conclusion that the statute has an unambiguous meaning that excludes timing. He gave examples in both tax and contract law in which the term "manner" has been seen as including timing.[33]

Also, three points were common to two or all three of the dissents. First, all three dissenters thought that the majority misread the earlier cases. They concluded that later cases modified *Anglo-American* and permit a timing rule.[34] That point is developed in Part II below.

Second, Judges Halpern and Holmes concluded that *Chevron*, not *National Muffler*, should provide the controlling standard and that the regulation is valid under *Chevron*.[35]

Third, Judges Holmes and Swift criticized the majority's legislative reenactment analysis. Judge Holmes pronounced himself "quite leery of the majority's formulation" of the doctrine, particularly "when it is used to *invalidate*, rather than uphold, a regulation."[36] The majority had added its formulation "for sake of completeness,"[37] but the majority's formulation was itself incomplete. The legislative reenactment doctrine does not apply "where nothing indicates that the legislature had its attention directed to the administrative interpretation upon reenactment."[38] There are cases that invoke the doctrine without establishing this predicate condition. Nonetheless, the better view is that the doctrine either doesn't apply or carries little weight, absent legislative awareness of the interpretation.[39] Thus, "the majority's reliance on legislative reenactment should have ended when it could find no affirmative evidence that Congress knew of any of the [cases] which the majority had invoked."[40]

Judge Swift also noted that the Tax Court had previously stated, "We do not believe that the legislative reenactment doctrine can be applied to bar reasonable amendments to regulations where . . . the change is made only prospectively from the date of the announcement of the proposed change."[41] The 1990 regulation was prospective in that regard.

II. Prior Cases Support Some Timing Requirement

The *Swallows* majority misread the case law on which it relied. Three tribunals — the BTA, the Tax Court, and the Fourth Circuit[42] — decided the nine prior cases. At the end of the day, all three of those tribunals — far from rejecting timing as a component of section 882 — agreed that some timing aspect is implicit in the statute.

The prior cases divide into two groups: the first three decisions and the later six decisions. As shown below, the first group sent mixed signals and need not be read as flatly prohibiting any timing requirement. Even if the first group were so read, however, the second group effectively overruled that position and clearly embraced the notion that some timing limitation is consistent with the statute.

A. First Three Decisions

The BTA first considered the issue in the *Anglo-American* case in 1938.[43] The foreign corporation did not

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T.C.M. (CCH) 3231, *Doc 96-18802, 96 TNT 127-14*. The cases are discussed at 126 T.C. at 112-125.

[30]126 T.C. at 139-142.

[31]Most of the cases involved years before 1990. The regulation was in existence for some of the years at issue in *Espinosa* and *InverWorld*. However, the Tax Court resolved those cases on the basis of precedent, obviating the need to assess the validity of the regulation. *Espinosa*, *supra* note 27, at 158; *InverWorld*, *supra* note 29, at 3237-3255.

[32]126 T.C. at 149.

[33]*Id.* at 165-166. The tax examples are reg. section 1.179-5(a) implementing section 179(c) and reg. section 1.826-1(c) implementing section 835(c)(2).

[34]126 T.C. at 150-151 (Judge Swift), 158-160 (Judge Halpern), and 167-168 (Judge Holmes).

[35]*Id.* at 157-162 (Judge Halpern) and 172-182 (Judge Holmes).

[36]*Id.* at 169 (emphasis in original).

[37]*Id.* at 139.

[38]*Id.* at 155 (Judge Swift) (*quoting* 2B Norman J. Singer, *Sutherland Statutory Construction* section 49:09 (6th ed. (2000)).

[39]*See, e.g.*, William D. Popkin, *Materials on Legislation: Political Language and the Political Process* 632 (4th ed. 2005).

[40]126 T.C. at 170 (Judge Holmes).

[41]*Id.* at 156 (*quoting Wendland v. Commissioner*, 79 T.C. 355, 384 (1982), *aff'd sub nom., Redhouse v. Commissioner*, 728 F.2d 1249 (9th Cir. 1984)).

[42]For foreign corporations without a principal place of business or principal office or agency in any U.S. judicial district, venue for appeal of a Tax Court decision is determined by reference to the IRS office where the corporation's returns are filed. Section 7482(b)(1)(B). For the years involved in the early cases, foreign corporations filed their returns with the collector of internal revenue in Baltimore, which is why the Fourth Circuit was the appellate court in those cases. For the years at issue in *Swallows*, foreign corporations filed their returns with the IRS campus in Philadelphia, which is why *Swallows* is on appeal to the Third Circuit. *See* 126 T.C. at 105-106 and n.9.

[43]*Anglo-Am. Direct Tea Trading Co., Ltd. v. Commissioner*, 38 B.T.A. 711 (1938).

timely file returns for its 1932 and 1933 tax years. The IRS discussed the matter with a corporate officer in March 1935. In April 1935, without informing the corporation, an IRS agent prepared substitutes for returns (SFRs).[44] Before the commissioner had accepted the SFRs, the taxpayer filed its delinquent returns. Under the predecessor of current section 882, the IRS denied the deductions claimed on those returns because the returns were delinquent. The IRS's position appears to have been that returns filed even one day after the due date precluded claiming deductions.[45]

The BTA, in a reviewed decision and without dissent, rejected the IRS's position. The board defined "manner," which appeared in the statute then the same way as it does now. The board acknowledged linguistic ambiguity.

> It is true, as [the IRS] points out, that "manner" is a comprehensive term, and includes, but is more comprehensive than, "method, mode, or way." But whether it is broad enough to include the element of time is a more difficult question. In some instances it has been construed by courts as including time; while in others it has been construed as not including it.[46]

Nonetheless, employing a "clear statement" approach,[47] the BTA concluded that in the context of the statute, "manner" did not include a time element. "If Congress had intended to deprive a foreign corporation of its right to deduct[ions] if it did not file its return within the time prescribed, we think it would have said so."[48]

However, the BTA stated its holding thusly: "We hold, therefore, that the mere fact that the return was not filed within the time prescribed by [what is now code section 6072] does not, under the circumstances present here, preclude the allowance of the deductions claimed."[49] The wording "under the circumstances present here" holds out the possibility of a different result on different facts. Moreover, the holding rejects only a time cutoff fixed at the due date for the filing of the return. It does not reject all possible more lenient cutoffs, such as the 18-month period under the 1990 regulation.[50] By virtue of its holding, therefore, *Anglo-American* need not stand for the absolute proposition that no timing requirement whatsoever is permissible under what is now section 882(c)(2).

Anglo-American was followed in short order by two BTA memorandum decisions: *Mills* and *American Investment*.[51] In their essential facts, those cases resembled *Anglo-American*, and the BTA resolved the cases in the taxpayers' favor, citing *Anglo-American* but providing no further analysis.

B. Six Subsequent Decisions

The three early decisions did not end the BTA's consideration of the issue. Slightly over a year after *Anglo-American*, the BTA decided *Taylor Securities*. The foreign corporation had not filed returns for tax years 1930 through 1935. In March 1937 the IRS issued a notice of deficiency for the years based on SFRs. In June 1937 the corporation filed a petition with the BTA. The IRS timely answered. Hearing was set for December 5, 1938, but was continued until January 16, 1939. The taxpayer filed the delinquent returns on December 13, 1938.

The board distinguished *Anglo-American* because in that case the returns had been filed before the deficiency notice was issued, the returns had been audited, and the commissioner had not accepted the SFRs.[52] "Nor did we decide there the question raised on argument here [which] is whether the [corporation], by filing returns after the [commissioner] made his determination of deficiencies," satisfied the statutory condition for allowance of the deductions.[53]

In a reviewed decision (with two members concurring on other grounds and three dissenting), the BTA resolved this question in favor of the IRS. The board stated that, under the statute:

> the allowance to foreign corporations of the credits and deductions ordinarily allowable is specifically predicated upon such corporations filing returns. In view of such a specific prerequisite it is inconceivable that Congress contemplated by that section that taxpayers could wait indefinitely to file returns

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[44]There are two types of SFRs. One type is prepared by the IRS from available information but is presented to, and is signed by, the taxpayer. Section 6020(a). The other type is prepared by the IRS but not signed by the taxpayer. Section 6020(b). The SFRs discussed in this article are of the second type. For discussion of some of the issues raised by SFRs, see Bryan T. Camp, "The Function of Forms in the Substitute-for-Return Process," *Tax Notes*, June 26, 2006, p. 1511.

[45]*See* 38 B.T.A. at 713-714.

[46]*Id.* at 714 (numerous cited cases omitted).

[47]If a court dislikes a particular substantive result, a common device is to declare something like "we will attribute to Congress an intention to produce that result only if the statute contains a clear statement of that intention" and then to hold that such a clear statement is absent from the statute. *See generally* William V. Luneburg, "Justice Rehnquist, Statutory Interpretation, the Policies of Clear Statement, and Federal Jurisdiction," 58 *Ind. L.J.* 211 (1982). For a recent Supreme Court case making double use of the "clear statement" approach, see *Rapanos v. United States*, 126 S. Ct. 2208, 2224 (2006) (plurality opinion).

[48]38 B.T.A. at 715. A later Tax Court case implicitly rejected this rationale and held that this draconian deprivation is intended to have an *in terrorem* effect furthering Congress's purpose of encouraging foreign corporations to file returns. *Espinosa v. Commissioner*, 107 T.C. 146, 152, 157 (1996).

[49]38 B.T.A. at 715.

[50]The *Swallows* majority stated that the IRS "acknowledges [that its position in *Swallows*] is the same as that rejected in *Anglo-Am.* . . . and its progeny." 126 T.C. at 99. If the IRS did make that concession, the concession was erroneous. Allowing the taxpayer an 18-month grace period after the return due date (the regulation) is considerably less burdensome on taxpayers than allowing no post-due-date grace period (the IRS's litigating position in *Anglo-American*). In any event, a regulation has higher dignity than a litigating position. *See* ABA Section of Taxation Report of the Task Force on Judicial Deference (hereafter ABA Deference Report), 57 *Tax Law.* 717, 758-759 (2004).

[51]*Mills, Spence & Co., Ltd. v. Commissioner*, 1938 WL 8403 (B.T.A. memo. 1938); *American Inv. & Gen. Trust Co., Ltd. v. Commissioner*, 1939 WL 12044 (B.T.A. memo. 1939).

[52]*Taylor Sec. Inc. v. Commissioner*, 40 B.T.A. 696, 702-703 (1939).

[53]*Id.* at 703.

> and eventually when the [IRS] determined deficiencies against them that they could then by filing returns obtain all the benefits to which they would have been entitled if their returns had been timely filed. Such a construction would put a premium on evasion, since a taxpayer would have nothing to lose by not filing a return as required by the statute.[54]

It is not entirely clear whether the *Taylor Securities* board adopted a fixed moment for when a return would be too late, although a possible reading is that a return filed after issuance of the notice of deficiency is too late. What *is* clear, however, is that the BTA abandoned in *Taylor Securities* what it may have said in *Anglo-American*. The statute *does* contain a timing element, after all. At some point, a return is filed too late, forfeiting otherwise available deductions.

That teaching of *Taylor Securities* has remained the law ever since, at least until *Swallows*. All post-*Taylor Securities* cases confirmed that the statute implies some cutoff time.

The first cases confirming that were *Ardbern, Blenheim,* and *Geerday,* decided by the BTA in 1940 and upheld, on the essential point, by the Fourth Circuit.[55] In *Ardbern,* the foreign corporation did not timely file its 1929 through 1932 returns. The IRS contacted the corporation about the missing returns, after which, in June 1937, the corporation tried to file the returns with an IRS agent. Then, however, the law required those returns to be filed with the collector of internal revenue in Baltimore, so the agent refused to accept the returns. In July 1937 the IRS issued a notice of deficiency and prepared SFRs. The corporation's petition to the BTA was filed in September 1937, and the IRS's answer was filed in December 1937. After further attempts, the corporation properly filed the returns in October 1938.

The BTA held for the IRS on the strength of *Taylor Securities*. In a confused opinion, the Fourth Circuit modified and remanded but for reasons unique to the case. The Fourth Circuit faulted the IRS agent for not directing the taxpayer, when it proffered the returns in June 1937, to file the returns with the collector in Baltimore.[56] The court continued:

> It is conceded that, if the returns . . . had been properly filed before the Collector at Baltimore, taxpayer would have been entitled to the deductions claimed . . . [The taxpayer should prevail when] he shows that prior to . . . assessment [of the deficiency] he attempted in good faith to file a return in which such deductions were claimed. This is nothing but elementary justice, and we find nothing in the statute which forbids it.[57]

The words "prior to . . . assessment" seemed to signal the Fourth Circuit's agreement that the statute contains a timing element, although perhaps a different time (making of the assessment) than the BTA may have suggested in *Taylor Securities* (issuance of the notice of deficiency).[58] However, the Fourth Circuit followed the above quotation with a quotation from *Anglo-American* that suggested there is no time element in the statute at all.[59] The court did not attempt to reconcile those inconsistent strands.

The Fourth Circuit also buttressed its conclusion by invoking the canon that doubt regarding the meaning of tax statutes is resolved against the government and in

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[54]*Id.* at 703-704. The last sentence may be an exaggeration. Assuming the existence of an underpayment, the taxpayer could have "something to lose": a delinquency penalty imposed under what is currently section 6651. Also, failure to file may affect the corporation's ability to make some tax elections.

[55]*Ardbern Co., Ltd. v. Commissioner*, 41 B.T.A. 910 (1940), *modified and remanded on other grounds*, 120 F.2d 424 (4th Cir. 1941); *Blenheim Co., Ltd. v. Commissioner*, 42 B.T.A. 1248 (1940), *aff'd*, 125 F.2d 906 (4th Cir. 1942); *Geerday Enter., Ltd. v. Commissioner*, 1940 WL 10265 (B.T.A. memo. 1940), *aff'd*, 126 F.2d 384 (4th Cir. 1942).

[56]The circuit court acknowledged that "there is no statutory authority for the making or filing" of those returns with an IRS agent, or indeed with anyone "other than the Collector designated in the statute, to accept returns." Nonetheless, the court continued, "fair dealing between the Government and a taxpayer would require the agent to whom the returns were improperly tendered for filing to advise the taxpayer as to the official and place where the returns should be filed." 120 F.2d at 426.

(Footnote continued in next column.)

[57]*Id.* I have reservations about the court's reasoning. Fairness alone is not generally a judicially enforceable aspect of tax law, e.g., *Commissioner v. Kowalski*, 434 U.S. 77, 95-96 (1977), and the circuit court did not attempt to fit its conception of "elementary justice" into a recognized doctrine such as equitable estoppel. However, it is not necessary in this article to explore those reservations. *See generally* Richard J. Wood, "Supreme Court Jurisprudence of Tax Fairness," 36 *Seton Hall L. Rev.* 421 (2006).

It is possible, but not certain, that the "good cause" exception in the 1990 regulation would lead the IRS to waive the 18-month limitation were a case like *Ardbern* to occur now. *See* 126 T.C. at 154 (Swift, J., dissenting).

[58]However, it is not entirely clear that the Fourth Circuit understood "assessment" to differ from "issuance of a notice of deficiency." Assessment has a term of art meaning under section 6203. Generalist judges, however, sometimes use the term colloquially, as essentially equivalent to "determination." *See, e.g., Demirjian v. Commissioner*, 457 F.2d 1, 2 n.3 (3d Cir. 1972). It is unclear from *Ardbern* whether the circuit court was using assessment in its technical sense or its colloquial sense.

Moreover, even if the *Ardbern* court meant assessment in its technical sense, that position would be inconsistent with most of the cases. In general, assessment can't be made until after the IRS issues the deficiency notice and after the decision in any ensuing Tax Court (or, earlier, B.T.A.) case becomes final. Section 6213(a). As will be seen from the description of the other pre-*Swallows* cases *infra*, those cases do not defer the terminal date until so late in the process. *See, e.g., Espinosa*, 107 T.C. at 157 (rejecting, at least on the facts of that case, the taxpayer's argument that the terminal date is not earlier than the date of issuance of the deficiency notice).

[59]120 F.2d at 426 (*quoting* 38 B.T.A. at 716: "Inasmuch as separate sections deal with 'manner' and 'time,' we think it highly improbable that Congress ever intended to include the element of time in the section dealing primarily with the manner of filing.").

favor of the taxpayer.[60] That canon appeared in many cases in the first half of the 20th century but is now generally discredited.[61]

Any confusion created by *Ardbern* about the Fourth Circuit's view was cleared up by its decision in *Blenheim*, which strongly endorsed *Taylor Securities* and made no mention of *Anglo-American*. In *Blenheim*, the foreign corporation filed a personal holding company return (Form 1120H), but not a regular corporate income tax return (Form 1120), for tax year 1934. The IRS asked the corporation to file a Form 1120, but the corporation declined to do so. The IRS prepared an SFR in April 1938 and issued a deficiency notice in May 1938. The corporation filed the Form 1120 in August 1938.

The BTA held that the 1120H could not take the place of the Form 1120 since the personal holding company tax is separate and distinct from the corporate income tax.[62] The board held for the IRS, citing *Taylor Securities* for the proposition that a taxpayer cannot "take advantage from an alleged return submitted by the taxpayer not only after the [IRS prepares an SFR] but also after the issuance of a notice of deficiency."[63]

The board added that *Anglo-American* "does not aid petitioner, since it held only that a return filed before the determination of a deficiency was sufficient compliance."[64] That reading moves *Anglo-American* from "timing isn't part of the statute at all" to "timing is part of the statute and determination of the deficiency is the critical time demarcation." As noted above, the BTA's *Anglo-American* holding is in conflict with its "manner doesn't include timing" discussion. The BTA in *Blenheim* resolved the conflict by preferring the holding over the "manner" discussion.

The equitable factor present in *Ardbern* was not also present in *Blenheim*, and the Fourth Circuit affirmed. First, it held that the statute does contemplate a timing element. "It is true that [the statute] contains no reference to a time element. Nevertheless, we feel that the [Form 1120 filed in August 1938] was not a sufficient or timely compliance with [the statute] to entitle the petitioner to the deductions claimed therein."[65]

Second, the Fourth Circuit explained why a timing rule is implicit in the statute. The court noted the IRS's extended but unsuccessful efforts to induce the corporation to file voluntarily. The corporation's "inactivity and uncooperative attitude" forced the IRS to prepare an SFR.[66]

> The difficulty here encountered by the Commissioner in attempting to ascertain the petitioner's correct income tax is a striking example of the many administrative problems inherent in the application of the federal income tax to foreign corporations. This has prompted Congress to impose special conditions on such corporations. . . . This situation is pregnant with possibilities of tax evasion. In express recognition of this fertile danger to the orderly administration of the income tax as applied to foreign corporations, Congress conditioned its grant of deductions upon the timely filing of true, proper and complete returns.[67]

The *Blenheim* court identified the "SFR preparation" terminal date as originating from *Taylor Securities*, but the court did not treat that date as invariable.

> Without prescribing an absolute and rigid rule that whenever the Commissioner files a return [an SFR] for a foreign corporation the taxpayer is completely and automatically denied the benefit of deductions or credits, we yet hold that the facts of the instant case justify a disallowance of deductions which petitioner might otherwise have been entitled to claim, had it filed a timely return in compliance with the statutory requirement.[68]

Georday was a companion case to *Blenheim*. The return was filed more than five years after its due date, and also after the SFR, after the deficiency notice, and after the BTA petition. The Fourth Circuit denied the claimed deductions because the corporation failed to file "within the reasonable terminal period prescribed in the *Blenheim* case."[69]

A decades-long gap in the litigation ended with two 1996 Tax Court decisions: *Espinosa* and *InverWorld*.[70] In those cases, the Tax Court joined the BTA and the Fourth Circuit in concluding that section 882 includes a time element.

Espinosa involved section 874(a), which deals with nonresident alien individuals and is *in pari materia* with section 882(c)(2). The nonresident had not filed income tax returns for 1987 through 1991 when the IRS contacted him in November 1992. In February 1993 the IRS notified him that it had prepared SFRs. In March 1993 the IRS sent him a "doomsday" letter stating that he could no longer claim deductions for the years. In October 1993 the nonresident filed his returns for the years 1987 through 1991. In January 1994 the IRS issued a deficiency notice.

The court noted that section 874, like section 882, contains no time limit "on its face,"[71] and it described the two sections as "draconian provisions designed to induce foreign corporations and nonresident alien individuals to file tax returns."[72] Based on its rehearsing the cases described above, the Tax Court made three observations:

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[60]120 F.2d at 426 (*quoting United States v. Merriam*, 263 U.S. 179 (1923)).

[61]*See generally* Steve R. Johnson, "Should Ambiguous Revenue Laws Be Interpreted in Favor of Taxpayers?" *Nevada Lawyer*, April 2002, at 15.

[62]42 B.T.A. at 1251-1252; *see* section 541.

[63]42 B.T.A. at 1251.

[64]*Id.*

[65]125 F.2d at 908.

[66]*Id.* at 909.

[67]*Id.*; *see also id.* at 910. In addition to policy, the *Blenheim* court justified its result by perceived congressional intent and by reference to regulations under the statute regarding nonresident alien individuals, which essentially parallels the statute regarding foreign corporations. *Id.* at 909-910.

[68]*Id.* at 910.

[69]126 F.2d at 388.

[70]*Espinosa*, *supra* note 27; *InverWorld*, *supra* note 29.

[71]107 T.C. at 150.

[72]*Id.* at 152 (*citing Blenheim*, 125 F.2d at 909).

(1) "Although section 874(a) contains no express time limit, at some point there exists a terminal date, after which a taxpayer can no longer claim the benefit of deductions by filing a return."[73] (2) The terminal date is not the return due date established under section 6072.[74] (3) Absent "compelling equitable considerations," as in *Ardbern*, "a taxpayer cannot claim the benefit of deductions by filing a return after the Commissioner has prepared a substitute return and issued a notice of deficiency."[75]

The rationale for the timing element is "the policy behind the provisions.... If no cut-off point existed, taxpayers would have an indefinite time to file a return, and these provisions would be rendered meaningless.... The prior case law established the terminal date ... to ensure that [the sections] would have the *in terrorem* effect that Congress intended."[76]

The facts of *Espinosa* differed from those of some of the prior cases. In *Espinosa*, the returns were filed after the IRS prepared the SFRs but before it issued the notice of deficiency. The taxpayer argued, first, that the statute includes no time element at all and, second, in the alternative, that the terminal date should be the date the notice of deficiency is issued. The Tax Court rejected both of the taxpayer's arguments "where, as here, the Commissioner has notified the taxpayer that he has not filed a return and has given the taxpayer a reasonable time within which to file a return."[77]

Finally, in *InverWorld* the foreign corporation had not filed its returns for the years at issue — not even by the date of trial of the case. On the strength of *Georday* and *Blenheim*, the Tax Court denied deductions sought by the corporation.[78]

C. Summary

The preceding discussion shows that, if *Anglo-American* ever stood for a "no timing element" rule, that rule was abandoned by the subsequent cases. At the end of the day, all three tribunals that had considered the question — the BTA,[79] the Fourth Circuit,[80] and the Tax Court[81] — agreed that some timing requirement, some terminal date, is implicit in section 882.

Significantly, even the *Swallows* majority conceded that the prior cases establish that section 882(c)(2) implies a timing requirement — although the majority appears not to have recognized that it was making that concession. At first, the majority rejected the existence of this requirement, stating: "The disputed regulations were issued after both the Court of Appeals for the Fourth Circuit and the Board had repeatedly and consistently held that the relevant text did not include a timely filing requirement."[82]

If, by "a timely filing requirement," the majority meant a terminal date the same as the section 6072 filing date,[83] the statement is correct but beside the point since the 1990 regulation does not use the section 6072 filing date as the terminal date. If instead the majority meant that the prior cases rejected *any* terminal date or event, the majority immediately contradicted itself. The majority attached a footnote to the sentence quoted above. The footnote reads:

> The relevant meaning that we distill from the referenced cases of the Court of Appeals for the Fourth Circuit and the Board is twofold. First, a foreign corporation must file a tax return in order to deduct its expenses. Second, the Commissioner's preparation of a substitute return for the corporation is generally considered to be the corporation's return for Federal income tax purposes and divests the taxpayer of its entitlement to file a return for itself.[84]

The majority's footnote contradicts its "no timing rule" view: The SFR "rule"[85] *is* a timing rule. The majority is saying that the corporation can file its own return (and claim any deductions) until the date the IRS prepares an SFR. After that date, the corporation can no longer file its own return (and so loses its deductions). A timing requirement remains a timing requirement regardless of whether its terminal date is expressed by (1) year, month, or day; or (2) the date of the occurrence of some measuring event.[86]

III. Treasury, Not the Courts, Should Draw the Line

Based on the prior case law, the question no longer is "Is there a terminal date or event?" The cases say that there is. The questions now are "What should that date be?" and "Who — Treasury or the courts — should select that date?" It is to those questions that we now turn.

The relevant questions entail line-drawing. Below, I argue first that there was room for Treasury to draw the timing line in 1990 since the line had not previously been

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[73]107 T.C. at 156 (*citing Taylor Securities* and *Blenheim*).
[74]*Id.* (*citing Anglo-American*).
[75]*Id.* (*citing Blenheim* and *Taylor Securities*).
[76]*Id.* at 157.
[77]*Id.*
[78]71 T.C.M. at 3237-3256.
[79]In *Taylor Securities*, *Ardbern*, *Blenheim*, and *Georday*.
[80]In *Ardbern* (absent unusual circumstances not present in *Swallows*), *Blenheim*, and *Georday*.
[81]In *Espinosa* and *InverWorld*.
[82]126 T.C. at 137; *see also id.* at 98 (referring to "the consistent interpretation of the relevant text by the Court of Appeals for the Fourth Circuit and the Board not to include any timely filing requirement") and 123-124 ("The Court in *Espinosa* did not limit *Anglo-Am. Direct Tea Trading Co., Ltd.* to that observation or to any other point.").
[83]Judge Halpern correctly noted in dissent that the majority's use of the term "timely" is confusing. *Id.* at 158.
[84]*Id.* at 137 n.22; *see also id.* at 142-143.
[85]It would be too strong to say the prior cases fixed the timing requirement at the date the SFR is prepared. The cases suggest other possibilities as well without definitely selecting among the various possibilities. *See* Part III.A.
[86]For example, the duration of an automobile warranty could be phrased as "for 50,000 miles or one year from the date of purchase, whichever comes first." That language imposes a time limit on the warranty, whether measured by event or date.

drawn definitively and second that drawing lines concerning the timing of return filing is appropriately an administrative, not a judicial, matter anyway.

A. Absence of Definitive Prior Rule

If Congress had provided clear instructions on where to draw the line regarding time of return filing, the sole task would be to implement those instructions. But Congress did not provide those instructions, either in the statutory text or in legislative history. In that respect, our situation is similar to that in the *Fulman* case in which the Supreme Court remarked, in the process of upholding a tax regulation: "While obviously some rule . . . must be applied, Congress . . . failed expressly to provide one."[87]

That leaves drawing the line to Treasury since, as shown in Part III.B, Treasury is the "gap filler" in our tax system. However, it was not until 1990 — more than 60 years after the first iteration of what is now section 882 — that Treasury responded via regulations to the statutory gap regarding time cutoff.

In the intervening decades, had the courts filled the gap by developing a timing rule? Based on the case law review in Part II, the answer is no. The courts resolved the specific controversies before them, but, in doing so, developed nothing that could be called a defined and settled rule.[88]

As shown in Part II.B, possible terminal dates appearing in the cases ranged from the date SFRs were prepared, to the date of the "doomsday" letter, to the date of the deficiency notice, to the dates of the trial court pleadings, to the assessment date. Moreover, that already moving target might, the cases suggested, be moved a bit more by circumstances such as whether the taxpayer tried in good faith to file returns earlier; whether, how often, and with what intensity the IRS contacted the taxpayer about the missing return(s); and whether a "reasonable" time had passed after the IRS contacted the taxpayer. The prior cases are studded with flexibility-driven modifiers like "under the circumstances here present"[89] and "without prescribing an absolute and rigid rule."[90]

Had there been a settled judicial rule, a *Brand X* issue would have arisen.[91] I think the 1990 regulation would be upheld under *Brand X* analysis, but that is a topic for the second article. For present purposes, it is enough to note that there is no competition here between the regulation and an established judicial rule. The prior cases were too variable, flexible, and uncertain to stand for a settled rule.

B. Administrative, Not Judicial, Prerogative

When there is a statutory gap to be filled (in this case, a line in time to be drawn), the relevant administrative agency, not a court, is the appropriate body to perform the task. Congress has made that clear in the area of tax via section 7805(a),[92] and the Supreme Court has made it clear in administrative law generally. The Court said in *Chevron*: "The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress."[93] Even as to an implicit delegation, "a court may not substitute its own construction . . . for a reasonable interpretation made by the administrator of an agency."[94]

But one need not depend on *Chevron* to reach that result in the *Swallows* context. The *Swallows* majority erected *National Muffler* as the controlling standard. Both the line of cases of which *National Muffler* is a part and *National Muffler* itself made it clear that gap-filling and line-drawing are up to Treasury and the IRS. In the oft-cited *Correll* case, a forerunner of *Natinal Muffler*, the Supreme Court said:

> Alternatives to the Commissioner's sleep or rest rule are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing all needful rules and regulations for the enforcement of the Internal Revenue Code. In this area of limitless factual variations, it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.[95]

Numerous other cases of the same line are to the same effect.[96] So is *National Muffler* itself. After quoting the above language from *Correll*, *National Muffler* offered reasons for administrative primacy in promulgating subsidiary rules. It "helps ensure that in this area of limitless factual variations, like cases will be treated alike. It also helps guarantee that the rules will be written by masters of the subject, who will be responsible for putting the rules into effect."[97]

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[87]*Fulman v. United States*, 434 U.S. 528, 533 (1978).

[88]The cases did not "provide guidance of general applicability concerning timeliness: [they] merely resolve[d] issues created by unique fact patterns on a case-by-case basis. . . . Those cases do not unambiguously establish the limits of timeliness. . . . Timeliness is required, but timeliness is not defined." 126 T.C. at 160 (Halpern, J., dissenting).

[89]*Anglo-Am.*, 38 B.T.A. at 715.

[90]*Blenheim*, 125 F.2d at 910.

[91]*See National Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 125 S. Ct. 2688, 2700 (2005) (holding that "[a] court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion").

[92]Treasury "shall prescribe all needful rules and regulations for the enforcement of [the Code]." Section 7805(a); *see, e.g., Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110, 114 (1939).

[93]*Chevron*, 467 U.S. at 843 (*quoting Morton v. Ruiz*, 415 U.S. 199, 231 (1974)).

[94]*Chevron*, 467 U.S. at 844.

[95]*United States v. Correll*, 389 U.S. 299, 306-307 (1967) (citations, quotation marks, and footnotes omitted).

[96]*See, e.g., United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 218-219, *Doc 2001-11045, 2001 TNT 75-7* (2001); *Commissioner v. Portland Cement Co.*, 450 U.S. 156, 169 (1981); *United States v. Cartwright*, 411 U.S. 546, 550 (1973); *Bingler v. Johnson*, 394 U.S. 741, 749-751 (1969); *Commissioner v. Stidger*, 386 U.S. 287, 296 (1967).

[97]440 U.S. at 477 (quotation marks and citations omitted).

The *Swallows* majority invoked separation of powers concerns. It felt that, through the 1990 regulation, the executive branch had infringed on Congress's authority to make the laws and on the courts' authority to interpret them.[98] In my view, separation of powers concerns *are* implicated in *Swallows*, but they cut the other way. The real institutional-legitimacy problem in *Swallows* is that the Tax Court insufficiently honored the role of the agency in drawing lines under and filling gaps in the statute. As Judge Holmes said in dissent, the approach of the *Swallows* majority:

> simply doesn't reflect the contemporary understanding of administrative law that regulations are a way to make policy choices, not just a way to interpret ambiguous statutory phrases . . . [There are] different competencies of judges and regulation writers. Regulation writers are doing their jobs when they make up safe harbors and lay down deadlines; for judges to do so — instead of setting up fact-bound tests of "reasonableness" — looks like an exercise of legislative or administrative, rather than judicial, power.[99]

C. Summary

The prior cases established that a time limitation is implicit in section 882(c)(2). Congress did not instruct where to draw the line regarding timing and the courts established no settled rule regarding timing. Line-drawing and gap-filling are, anyway, properly the province of Treasury and the IRS. The agencies had the authority to promulgate a timing rule in the 1990 regulation.

IV. The Regulation's Timing Rule Is Reasonable

Treasury has the authority to fill in gaps in the code, but of course that authority is not unbridled.[100] Thus, we need to consider the contents of the 1990 regulation to ascertain whether Treasury exercised its line-drawing authority reasonably. For two reasons, I believe that it did. The regulation (1) effectively furthers the statutory purpose and (2) does not impose unreasonable burdens on taxpayers.

A. Statutory Purpose

It is common in statutory interpretation to favor the approach that best advances the purposes of the statute.[101] As shown below, the purpose of section 882(c)(2) is to motivate foreign corporations to file returns, and the bright line in the regulation furthers that purpose better than would the indefinite timing possibilities suggested in cases.

The relevant statutory purpose is to encourage the filing of returns. "The many administrative problems inherent in the application of the federal income tax to foreign corporations . . . prompted Congress to impose special conditions on such corporations."[102] Given the difficulties in gathering information about foreign corporations and their activities,[103] it is particularly important that foreign corporations file tax returns. Thus, "Congress conditioned its grant of deductions upon the timely filing of true, proper and complete returns."[104] "In view of such a specific prerequisite [in the statute] it is inconceivable that Congress contemplated . . . that taxpayers could wait indefinitely to file returns and [still be allowed to claim deductions]."[105]

The 1990 regulation advances that purpose via the certainty resulting from a bright line. Under the regulation, foreign corporations know that they will forfeit their ability to claim deductions if their returns are more than 18 months late. The rule is clear, definite, and understandable,[106] which should induce the desired behavior.

In contrast, as described in Part III.A, the prior cases "prescrib[ed] [no] absolute and rigid rule."[107] That meant that taxpayers could adopt a "wait and see" approach, hoping that their returns could be omitted entirely or, at least, be filed much later, without putting deductions at hazard. So (1) perhaps the IRS would never get around to preparing an SFR at all. (2) Even if the IRS did, it typically contacts the taxpayer before preparing an SFR.[108] The foreign corporation could wait until this contact, then file the returns, preserving its deductions. (3) Even if the returns were filed after the SFR was prepared, the taxpayer might have reason to hope that the reviewing court would select one of the other later terminal events mentioned in the case law, such as issuance of the notice of deficiency or making of the assessment.

Section 882(c)(2) was intended to motivate return filing via its *in terrorem* effect.[109] The bright-line approach of the regulation furthers that purpose. In contrast, the indefinite nature of the prior cases encourages a "little to lose by waiting" attitude on the part of foreign corporations. This would lead to what judges of prior cases

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[98]*See* 126 T.C. at 147-148.

[99]*Id.* at 174.

[100]The *Swallows* majority properly stated: "The authority delegated to the Secretary, however, is not limitless and, if exercised improperly, may usurp the role of Congress as the legislator in our system of Government." *Id.* at 129.

[101]*See, e.g., Zedner v. United States*, 126 S. Ct. 1976, 1985 (2006); *United Steelworkers v. Weber*, 443 U.S. 193, 202-204 (1979); *Church of the Holy Trinity v. United States*, 143 U.S. 457, 463-465 (1892); *see* William N. Eskridge Jr., Philip P. Frickey, and Elizabeth Garrett, *Legislation and Statutory Interpretation* 228-230 (2d ed. 2006).

[102]*Blenheim, supra* note 29, 125 F.2d at 909.

[103]The techniques available to the IRS to gather information abroad are described in David M. Richardson, Jerome Borison, and Steve Johnson, *Civil Tax Procedure* 101-102 (2005).

[104]*Blenheim, supra* note 29, 125 F.2d at 909; *see also* 126 T.C. at 182 (Holmes, J., dissenting) (section 882(c)(2) was "unambiguously aimed at giving foreign corporations a major incentive to file their returns").

[105]*Taylor Securities, supra* note 29, at 703-704.

[106]"The 18-month grace period might be shorter or longer than the old judicially constructed one. It is undeniably more definite." 126 T.C. at 162 (Holmes, J., dissenting).

[107]*Blenheim, supra* note 29, 125 F.2d at 910.

[108]*See* IRM 5.1.10.3.2 and 5.1.11.6.5. Regarding SFRs generally, see reg. section 301.6020-1T.

[109]*Espinosa, supra* note 27, at 157.

feared: "[putting] a premium on evasion."[110] Thus, the content of the regulation is reasonable because its clear rule better advances the congressional purpose.

The use of bright lines to further return filing and accommodate administrative realities is well known in our tax system. In a case involving the delinquency penalty, the Supreme Court chose a bright-line approach, saying:

> Deadlines are inherently arbitrary; fixed dates, however, are often essential to accomplish necessary results. The Government has millions of taxpayers to monitor, and our system of self-assessment in the initial calculation of a tax simply cannot work on any basis other than one of strict filing standards. Any less rigid standard would risk encouraging a lax attitude toward filing dates. Prompt payment of taxes is imperative to the Government, which should not have to assume the burden of unnecessary ad hoc determinations.[111]

B. No Unreasonable Burden

The viability of the 1990 regulation will turn mainly on its consistency with the statute, not on its effect on taxpayers. Nonetheless, in an inquiry as open-ended as reasonableness, little is out of bounds. Moreover, as *Ardbern* reminds us,[112] as long as human beings decide cases, perceived equities will always be relevant atmospherically, whether or not they're relevant doctrinally.

In that context, it is worth noting that the 1990 regulation neither traduces taxpayer reliance interests nor imposes hardships on taxpayers.[113] This is so for three reasons. First, taxpayers had notice of the regulation and time to adjust to it. The regulation was initially released in proposed form in July 1989.[114] After notice and comment, the final regulation was made effective for tax years ending after July 31, 1990.[115] Because income tax return filing is on an annual basis, all foreign corporations doing business in the United States had the opportunity to accommodate their filing practices to the rules set forth in the regulation. Certainly that was true of the *Swallows* taxpayer, since the promulgation of the regulation preceded by several years the first tax year at issue in the case.[116]

Second, the terminal date under the regulation generally is 18 months after the due date of the foreign corporation's return for the tax year. Third, the regulation has an answer to the unusual instances in which that 18-month period may not be enough. The 1990 version of the regulation provided that the time limitation "may be waived by the [IRS] in rare and unusual circumstances if good cause for such waiver . . . is established by the foreign corporation."[117] The waiver provision was revised, in 2002 and 2003 amendments, to apply if the corporation "establishes to the satisfaction of the [IRS] that the corporation . . . acted reasonably and in good faith in failing to file a U.S. income tax return."[118]

C. Summary

In *Atlantic Mutual*, the Supreme Court upheld another interpretive tax regulation that the Tax Court had thought invalid. The Court rejected the taxpayer's "plain meaning of the statute" argument,[119] and it approved the regulation because "the interpretation adopted by the . . . Regulation seems to us a reasonable accommodation — and one that the statute very likely intended — of the competing interests of fairness, administrability, and avoidance of abuse."[120]

A similar characterization, I believe, applies to the regulation at issue in *Swallows*. The regulation's bright-line terminal date promotes Congress's purpose in enacting section 882(c)(2) and responds to a genuine need in sound administration of the income tax regarding foreign corporations. Also, taxpayers are not unduly burdened by the regulation since they had notice of it, it was prospective in application, it grants a 1½-year grace period, and it provides for waiver of the terminal date in proper cases. The 1990 regulation is reasonable in substance.

V. Restoring *National Muffler* Deference

Invalidating a regulation is serious business because rather than affecting merely one taxpayer for one year, it affects a whole class of taxpayers for potentially many years. But the stakes in *Swallows* are even higher. The *Swallows* majority distorted the *National Muffler* standard. If its approach metastasizes to other cases, the original deferential nature of that standard could be compromised.

National Muffler is part of a line of cases that is specific to tax regulations and rulings, a line that originated before, has continued after, and exists in unclear relationship to *Chevron*.[121] Below, we first examine the deferential character of the line of cases generally. Then, we consider *National Muffler* specifically, including its animating spirit, general test, and specific considerations.

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[110] *Taylor Securities*, *supra* note 29, 40 B.T.A. at 703-704; *see also Espinosa*, *supra* note 27, at 157-158.

[111] *United States v. Boyle*, 469 U.S. 241, 249 (1985).

[112] *See Ardbern*, *supra* note 29, 120 F.2d at 426, discussed at text accompanying notes 56-57 *supra*.

[113] *Cf. Anderson, Clayton Co. v. United States*, 562 F.2d 972, 981 (5th Cir. 1977), *cert. denied*, 436 U.S. 944 (1978); *Lesavoy Foundation v. Commissioner*, 238 F.2d 589, 591-594 (3d Cir. 1956) (reliance and burden are among relevant factors in deciding whether a retroactive IRS revocation of a taxpayer-specific ruling is an abuse of discretion).

[114] 54 *Fed. Reg.* 31547 (July 31, 1989).

[115] T.D. 8322, 1990-2 C.B. 172; 55 *Fed. Reg.* 50827 (Dec. 11, 1990).

[116] 126 T.C. at 138; *see* text accompanying note 157 *infra*.

[117] Former reg. section 1.882-4(a)(3)(ii).

[118] Reg. section 1.882-4(a)(3)(ii).

[119] *Atlantic Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, 387-389, *Doc 98-12876*, *98 TNT 77-8* (1998).

[120] *Id.* at 390-391.

[121] *See generally* Paul L. Caron, "Tax Myopia Meets Tax Hyperopia: The Unproven Case of Increased Judicial Deference to Revenue Rulings," 57 *Ohio St. L.J.* 637, 654-669 (1996); ABA Deference Report, *supra* note 50, at 759-777.

A. Line of Cases Generally

The spirit in which a court applies a standard can be as important as, or more important than, the linguistic formulation of that standard.[122] The Supreme Court has repeatedly taught that the tax-specific line of authority of which *National Muffler* is a part is deferential.

In one frequently cited case, the Court said: "This Court has many times declared that Treasury regulations must be sustained unless unreasonable and *plainly inconsistent* with the revenue statutes."[123] Tax regulations will be upheld as long as they "implement the congressional mandate in *some* reasonable manner."[124] Moreover, even if the regulation is interpretive, not legislative, "we must still treat the regulation with deference."[125]

The Court's actual behavior in these cases corresponds to its rhetoric of deference. In numerous cases of this line, the Supreme Court reversed circuit court decisions invalidating regulations or subregulation IRS positions.[126]

In far fewer cases did the Supreme Court strike down a regulation, and those cases typically involved considerations not present in *Swallows*. For example, in *Vogel Fertilizer* and *Rowan* there were congressional committee reports adverse to the regulation;[127] no such reports are adverse to the *Swallows* regulation.[128] The problem with the regulation at issue in *R.J. Reynolds* was its retroactivity;[129] the *Swallows* regulation was prospective.[130] In *Cartwright*, the tax regulation for valuing securities was "manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operate[d] without regard to the market in mutual fund shares that the Act created and regulates."[131] The *Swallows* regulation does not clash with any nontax rule of law.

The situation in the lower federal courts defies neat categorization.[132] It is worth noting that the Tax Court's decisions have often been reversed when they have found "regulations unreasonable after the extensive review of the sort [it engaged in in *Swallows*]."[133] *Swallows* should be added to this regrettable roll.

Thus, the Supreme Court has made clear by word and deed that the line of authority of which *National Muffler* is a part is congenial, not hostile, to upholding Treasury regulations.[134] That spirit should be borne in mind by courts applying *National Muffler*.

B. *National Muffler*

The *Swallows* majority maintained that the 1990 regulation failed under *National Muffler* because the timing limitation "is inconsistent with the plain meaning of [the] statute."[135] It then analyzed six specific considerations that had been mentioned in *National Muffler*:

> (1) Whether the regulation is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent; (2) the manner in which a regulation dating from a later period evolved; (3) the length of time that the regulation has been in effect; (4) the reliance placed upon the regulation; (5) the consistency of the Secretary's interpretation; and (6) the degree of scrutiny Congress has devoted to the regulation during subsequent reenactments of the statute.[136]

Contemporaneity: The majority noted that the regulation was promulgated 62 years after the original version of section 882(c)(2) was enacted (and 72 years after the

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[122]For example, the *Skidmore* standard can result in deference ranging from 'great' to 'some' to 'little' depending on its application. ABA Deference Report, *supra* note 50, at 751; *see Skidmore v. Swift & Co.*, 323 U.S. 134, 139-140 (1944). Similarly, *Chevron* can be either indulgent or restrictive depending on how its steps are applied. *See, e.g.*, John F. Coverdale, "Court Review of Tax Regulations and Revenue Rulings in the *Chevron* Era," 64 *Geo. Wash. L. Rev.* 35, 39-40 (1995); Elizabeth Garrett, *Step One of Chevron v. Natural Resources Defense Council* (3d rev. draft), at 2-3, prepared for the Scope of Judicial Revision portion of the Project on the Administrative Procedure Act (June 2001), *available at* http://www.abanet.org/adminlaw/apa/chevron_revised_3.doc (last visited on June 22, 2006); Irving Salem and Richard Bress, "Agency Deference Under the Judicial Microscope of the Supreme Court," *Tax Notes*, Sept. 4, 2000, p. 1257.

[123]*Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948) (emphasis added).

[124]*Commissioner v. Portland Cement Co.*, 450 U.S. 156, 169 (1981); *United States v. Cartwright*, 411 U.S. 546, 550 (1973); *United States v. Correll*, 389 U.S. 299, 307 (1967) (emphasis added).

[125]*Boeing Co. v. United States*, 537 U.S. 437, 448, *Doc 2003-5648*, *2003 TNT 43-7* (2003).

[126]*See, e.g., United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001); *Commissioner v. Portland Cement Co.*, 450 U.S. 156 (1981); *Fulman v. United States*, 434 U.S. 528 (1978) (resolving circuit split); *Bingler v. Johnson*, 394 U.S. 741 (1969); *United States v. Correll*, 389 U.S. 299 (1967); *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496 (1948); *Helvering v. Winmill*, 305 U.S. 79 (1938); *United States v. Dakota-Montana Oil Co.*, 288 U.S. 459 (1933) (resolving circuit split); *cf. United States v. Boyle*, 469 U.S. 241 (1985) (same in a tax case citing *Chevron*).

[127]*United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 26-31 (1982); *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 255-258 (1981).

[128]The *Swallows* majority's best (but insufficient) attempt to identify a committee report favorable to its position was a "*cf.*" to a 1996 report under section 874 to the effect that losing their

(Footnote continued in next column.)

deductions "may result in quite heavy tax burdens" for nonresident alien individuals. 126 T.C. at 136 n.21 (*quoting* S. Rep. 1707, 88th Cong., 2d Sess. 26-77 (1966), *reprinted at* 1966-2 C.B. 1059, 1076-1077).

[129]*Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110, 116-117 (1939).

[130]T.D. 8322, 1990-2 C.B. 172, 172.

[131]*United States v. Cartwright*, 411 U.S. 546, 557 (1973).

[132]*See generally* ABA Deference Report, *supra* note 50, at 763-776.

[133]*Swallows*, 126 T.C. at 162 n.2 (Holmes, J., dissenting) (citing numerous cases in which the Tax Court was reversed on appeal after invalidating a regulation).

[134]Indeed, it may be that *Chevron* — which usually is considered deferential, e.g., *Rapanos v. United States*, 126 S. Ct. 2208, 2235-2236 (2006) (Roberts, C.J., concurring) (describing *Chevron* as a "generous" standard) — is less deferential regarding tax regulations than is the tax-specific line of cases. *See* Ellen P. Aprill, "Muffled *Chevron*: Judicial Review of Tax Regulations," 3 *Fla. Tax. Rev.* 51, 52 (1996).

[135]126 T.C. at 132; *see also id.* at 132-136.

[136]*Id.* at 136-137 (*citing* 440 U.S. at 477).

original version of substantially similar section 874(a)) and so was not a substantially contemporaneous construction.[137]

Manner of evolution: The majority offered four points adverse to the regulation on this score. (1) The regulation was issued after the Fourth Circuit and the BTA "had repeatedly and consistently held that the relevant text did not include a timely filing requirement."[138] (2) The regulation was issued after multiple reenactments of the statute, "none of which altered the judiciary's construction of the text."[139] (3) The regulations "merely adopted [the IRS's] unsuccessful litigating position."[140] (4) Commentators had objected to a time limitation in the regulation.[141]

Tenure: The majority noted that the 1990 regulation "had only been in effect for approximately three years as of the first year in issue."[142]

Reliance: "Petitioner obviously did not rely upon the disputed regulations when it filed the subject returns untimely. In fact, the record before us persuades us that petitioner filed those returns relying on the belief that it would be [able to claim its deductions]."[143]

Consistency: The 1957 regulations had not contained a timing limitation.[144]

Congressional scrutiny: "Section 882(c)(2) has not been amended since the issuance of the disputed regulation."[145]

In my view, the *Swallows* majority's treatment of *National Muffler* is deficient. It is wrong regarding many particulars, especially those that are most important. More seriously, it misperceives the role of the particulars in the overall analysis and it effectively converts *National Muffler* from a deferential standard into a hard-look standard.

1. Particulars. The six considerations mentioned in *National Muffler* were never intended to be applied in a wooden, "checklist" manner, as the Supreme Court made clear in the case itself. From that perspective, reconsider the *Swallows* majority's analysis.

Contemporaneity: The *Swallows* majority was right that the 1990 regulation is not a contemporaneous construction of the statute, but that means little. The taxpayer in *National Muffler* made the same argument, but the Supreme Court upheld the challenged regulation nonetheless. The Court remarked: "Contemporaneity, however, is only one of many considerations that counsel courts to defer to the administrative interpretation of a statute. It need not control here."[146]

Manner of evolution: All four of the *Swallows* majority's points in this regard are wrong or irrelevant. The prior cases had, in fact, rejected a "timely filing requirement," but the regulation does not require that the return be filed on time, only that it be filed not later than 18 months after it would have been timely.

The IRS won most of the prior cases, which makes talk of an "unsuccessful litigating position" sound strange. Moreover, the 18-month grace period in the regulation is considerably more indulgent than — and so does not merely repeat — the position the IRS started with in *Anglo-American*. And, of course, a regulation has more weight than a mere litigating position, even if their contents are identical.

I acknowledge that the views of commentators have some significance. (At least, as a matter of my own self-interest, I hope that is true.) However, the views of courts are more significant. As detailed in Part II above, the prior cases firmly established that some timing element is implicit in the statute. As detailed in Part III and Part IV, it was Treasury's job to define that time element and the 1990 regulation did so responsibly.[147]

That leaves only the *Swallows* majority's legislative reenactment argument. The majority observed that none of the reenactments altered the prior cases.[148] However, the majority presented no solid evidence that Congress was even aware of the prior cases when it was engaged in the reenacting.[149] The majority appeared to suggest that a demonstration of actual congressional awareness and approval is unnecessary because it can be "assume[d]" that Congress knows the law.[150] However, "though courts have stated this general proposition . . . *no* case has rested on this presumption alone as a basis for holding that the statute required [a particular] interpretation."[151] It is reasonable to assume that Congress is aware of major Supreme Court cases and of other cases that have become famous or notorious. It severely tests credulity, however, to assume that Congress is aware of all lower court decisions in highly technical nooks and crannies of the law. That being the case, I agree with the dissenters that the reenactment argument should not have been used at all.[152]

However, were that argument admissible, it would undercut, not support, the majority's *National Muffler* analysis. The 1928 statute was reenacted in 1932, 1934, 1936, 1938, 1939, 1954, 1966, and 1986.[153] The 1932, 1934, 1936, and 1938 reenactments shed no light on our issue

[137]126 T.C. at 137.
[138]*Id.*
[139]*Id.*
[140]*Id.*
[141]*Id.*; *see also id.* at 127-128.
[142]*Id.* at 138.
[143]*Id.*
[144]*Id.*
[145]*Id.*
[146]440 U.S. at 485.

[147]Treasury explained thusly its rejection of the commentators' objection. The terminal date was retained in the final regulation "since the statute clearly provides for the denial of deductions . . . if returns are not filed in a timely manner. This requirement is justified because of different administrative and compliance concerns with regard to nonresident alien individuals and foreign corporations." T.D. 8322, 1990-2 C.B. 172, 172.
[148]126 T.C. at 137.
[149]*See id.* at 140-142.
[150]*Id.* at 139 (*quoting Cannon v. University of Chicago*, 441 U.S. 677, 696-697 (1979)).
[151]*AFL-CIO v. Brock*, 835 F.2d 912, 916 n.6 (D.C. Cir. 1987) (emphasis in original).
[152]*See* Part I.C *supra*.
[153]*See* 126 T.C. at 107-109.

since they preceded the *Anglo-American* decision.[154] The 1939 reenactment occurred about four months after *Anglo-American*.[155] However, the 1939 legislation was the first codification of the formerly separate session laws that related to federal taxes. During those four months, it is doubtful that Congress — engaged in the great labor of initial codification of all the tax laws — learned of, carefully pondered, and decided that it agreed with the *Anglo-American* decision. Certainly, there is little evidence that it did.

Whatever minimal support the *Swallows* majority could gain from the 1939 reenactment would be more than overcome by the 1954, 1966, and 1986 reenactments. In 1939 through 1942, the BTA and the Fourth Circuit decided *Taylor Securities*, *Ardbern*, *Blenheim*, and *Georday*, which, as shown in Part II.B, established that a time limitation is implicit in the statute. If, in 1954, 1966, and 1986, Congress was approving anything, it was approving the then-current state of the law, which was defined by those post-*Anglo-American* cases.

On those facts, the 1954, 1966, and 1986 reenactments would be better evidence of Congress's intent than would the 1939 reenactment. Therefore, if (contrary to my view) the reenactment doctrine has any role to play in *Swallows* at all, that doctrine undermines, rather than supports, the *Swallows* holding.

Tenure: The majority stated that the regulation was promulgated about three years before the first tax year at issue in *Swallows*.[156] That computation might be challenged,[157] but there is no need to quibble. Three years is more than enough to put a taxpayer on notice. Moreover, of course, many regulations are challenged relatively early in their lives, and courts have often upheld regulations promulgated only a few years before the first tax year at issue.[158]

Reliance: It would be strange to say that a reason the regulation should not receive deference is that the taxpayer challenging a regulation did not rely on the regulation. That position would encourage noncompliance and presumably would put an adverse "thumb on the scale" in all or most cases in which regulations are challenged. Surely that's not what the Supreme Court was trying to do in *National Muffler*.

Consistency: As a litigating position, the IRS consistently argued that what is now section 882(c)(2) authorizes a timing limitation although its position changed as to what the terminal date of that limitation is.[159] After it lost in *Anglo-American*, the IRS published a nonacquiescence to the case[160] and it continued litigating later cases.

The 1957 regulation did not set out a time limit. Neither, however, did it affirmatively state that deductions could be claimed, regardless of how late the return was filed.[161] In any event, a change of regulatory substance is not a doctrinal kiss of death. *National Muffler* itself upheld a challenged regulation even though the regulation constituted an administrative shift. In that case, the Supreme Court said: "We would be reluctant to adopt the rigid view that an agency may not alter its interpretation in light of administrative experience."[162] The Court has said the same in many other cases, both before[163] and after[164] *National Muffler*. "An initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis."[165]

Congressional scrutiny: Section 882(c)(2) has not been amended since 1990, so Congress has neither endorsed nor repudiated the 1990 regulation. This is a nonfactor.

2. Overall analysis. As shown above, I believe that the six considerations listed in *National Muffler* support, rather than undercut, the validity of the regulation at issue in *Swallows*. While discussing those considerations, however, we need to resist myopia. Those considerations are not independent. Instead they are intended to illuminate the ultimate inquiry, which is whether the regulation harmonizes with the language, origin, and purpose of the statute.[166] Based on Parts II, III, and IV of this article, I believe that the 1990 regulation comfortably passes muster under that ultimate inquiry.

The *Swallows* majority appears to have lost sight of the spirit behind that inquiry. The portion of *National Muffler* that the majority quoted is bracketed by deferential language that the majority passed over. Before the quoted language is a strong reaffirmation that Congress delegated the authority to prescribe needed rules to Treasury, not the courts, and that regulations should be upheld

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[154]*Anglo-American* was decided on Oct. 4, 1938. The 1938 reenactment was on May 28, 1938. Revenue Act of 1938, ch. 289, 52 Stat. 447, 531.

[155]The 1939 legislation was approved on Feb. 10, 1939. Internal Revenue Code of 1939, 53 Stat. 1, 79, 510. *Mills* (decided on Oct. 5, 1938) also preceded the 1939 legislation by slightly more than four months. However, as a BTA memorandum decision, *Mills* is even less likely than *Anglo-American* to have garnered congressional attention and approval. The other early BTA memorandum decision, *American Investment*, was decided on Apr. 13, 1939, after the 1939 legislation.

[156]126 T.C. at 138.

[157]The majority's three-year calculation presumably reflects the span between the finalization of the regulation in December 1990 and the June 1, 1993, start of the taxpayer's 1994 fiscal year. Beginning the span instead with the July 1989 date the regulation was initially proposed or ending the span with the expiration of the 18-month grace period would produce a spread considerably longer than three years. Of course, the spreads are longer yet for the other years at issue in *Swallows*, 1995 and 1996.

[158]*See, e.g., Boeing Co. v. United States*, 537 U.S. 437 (2003) (regulation promulgated in 1977; first tax year at issue: 1979); *Fawcus Mach. Co. v. United States*, 282 U.S. 375 (1931) (regulation promulgated in April 1919; first tax year at issue: 1919).

[159]*See* 126 T.C. at 154 (Swift, J., dissenting).

[160]1939-1 C.B. (pt. 1) 39.

[161]*See* former reg. section 1.882-4, 22 *Fed. Reg.* 8362 (Oct. 23, 1957).

[162]440 U.S. at 485. The cases described in Part II.B explain why "administrative experience" made clear the need for a timing rule. *See, e.g., Blenheim Co., supra* note 29, 125 F.2d at 910.

[163]*E.g., Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 101 (1939).

[164]*E.g., National Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 125 S. Ct. 2688, 2699-2700 (2005).

[165]*Chevron*, 467 U.S. at 863.

[166]440 U.S. at 477.

if they implement the statute "in some reasonable manner."[167] Near the end of *National Muffler*, the Supreme Court again instructed that: "The choice among reasonable interpretations is for the Commissioner, not the courts."[168]

The *Swallows* majority viewed the six considerations through the wrong lens. One can view those considerations as either subtractive or additive in nature. Under a subtractive approach, the absence or failure of one or some considerations would decrease the level of deference accorded, or strip away deference entirely, or even constitute reason to reject the position taken in the regulation. In contrast, under an additive approach, the absence or failure of some considerations would not lessen deference; instead, their presence or satisfaction would cause even extra deference, "super deference," to be accorded to the regulation. The subtractive approach is "starts high but can go low (or even negative)," while the additive approach is "starts high and can go even higher."

The *Swallows* majority used the six considerations subtractively. While examples of both subtractive and additive use can be found in the numerous cases applying *National Muffler*, I believe that the additive approach better reflects the Supreme Court's deferential approach in that case.

The *National Muffler* Court followed the enumeration of the considerations with citation to two cases — *South Texas Lumber* and *Winmill*[169] — and indeed most of the six considerations are explored or mentioned in one or both of those cases. Significantly, both of the cited cases upheld the regulations there at issue. They used such of those considerations as were present as support for the regulations' validity.

I see *National Muffler* as similar in this spirit to the Supreme Court's *Dixon* decision,[170] which in another tax context clearly chose the additive over the subtractive approach. In *Dixon*, the taxpayer argued that the IRS had abused its discretion in giving retroactive effect to its withdrawal of an acquiescence to a prior case. As part of his argument, the taxpayer looked to an earlier case, *Automobile Club of Michigan*,[171] in which the Court had upheld another retroactive IRS decision.

The *Dixon* taxpayer argued that considerations mentioned in *Automobile Club of Michigan* were not present in *Dixon*, so that *Dixon* should reach a different result. That was a subtractive argument, and the *Dixon* Court rejected it.

> Although we mentioned certain facts in support of our conclusion in *Automobile Club* that there had not been an abuse of discretion in that case, it does not follow that the absence of one or more of these facts in another case wherein a ruling or regulation is applied retroactively establishes an abuse of discretion.[172]

Dixon's approach to the abuse of discretion considerations should also be the approach taken regarding the *National Muffler* considerations. An additive approach according extra deference when some conditions are present better fits the deferential spirit of *National Muffler* than does a subtractive approach.

When its guiding spirit is ignored, *National Muffler* is distorted. No longer a shield protecting regulations when fairly possible under the governing statute, *National Muffler* becomes a sword to cut down regulations when judges dislike their content. The majority's approach is not deference. It is a hard-look approach.[173] Reversing *Swallows* would restore *National Muffler*, and the line of which it is a part, to their proper role.

VI. Conclusion

The result reached in *Swallows* could be reversed on *Chevron* or *Brand X* grounds, as the dissents maintained[174] and as I will argue in the second report. However, the Third Circuit has yet to apply *Chevron* to interpretive tax regulations,[175] and judges sometimes prefer to resolve cases on the narrowest or least ambitious ground available.[176] Accordingly, this report has shown that *Swallows* can and should be reversed even on the basis of *National Muffler*, the standard that the *Swallows* majority purported to apply.

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[167] *Id.* at 476-477 (citing many cases).

[168] *Id.* at 488.

[169] *Id.* at 477 (*citing Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); *Helvering v. Winmill*, 305 U.S. 79, 83 (1938)).

[170] *Dixon v. United States*, 381 U.S. 68 (1965).

[171] *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180 (1957).

[172] 381 U.S. at 76.

[173] *See* 126 T.C. at 174 (Holmes, J., dissenting). As to the "hard look" doctrine generally, see Merrick Garland, "Deregulation and Judicial Review," 98 *Harv. L. Rev.* 505, 525-527, 554 (1985).

[174] *Id.* at 149-150 (Judge Swift), 157-162 (Judge Halpern), and 171-182 (Judge Holmes).

[175] The key Third Circuit case thus far is *E.I. du Pont de Nemours & Co. v. Commissioner*, 41 F.3d 130, 135-136, and n.23, *Doc 94-10819, 94 TNT 240-6* (1994), which considered but did not decide whether *Chevron* applies to interpretive tax regulations. In *Cleary v. Waldman*, 167 F.3d 801, 807 (1999), a nontax case, the Third Circuit held that *Chevron* applies to regulations promulgated through the familiar notice-and-comment process. *See* 5 U.S.C. section 553(b). Interpretive tax regulations virtually always go through that process. *See* proc. reg. section 601.601.

[176] This approach is typified by recent remarks by Chief Justice John G. Roberts Jr.: "If it is not necessary to decide more to dispose of a case, in my view it is necessary not to decide more." E.J. Dionne Jr., "The Chief Justice Sets a Standard," *The Washington Post*, June 20, 2006, at A17 (*quoting* Chief Justice Roberts's May 21, 2006, speech to the graduating class of Georgetown University School of Law); *see also* David Pannick, Q.C., "I Used to Be a Judge but I'm All Right Now," *The Times (London)*, June 6, 2006, at 5 ("a wise judge never decides more than is necessary to dispose of the case").

A fairly recent example in tax is the Supreme Court's decision in *Ballard v. Commissioner*, 544 U.S. 40, 58-59, *Doc 2005-4642, 2005 TNT 44-12* (2004). The Court largely avoided meaty statutory and constitutional issues by holding narrowly that the Tax Court didn't understand what its own rule meant. That approach was surprising given the high level of deference traditionally accorded to courts' and agencies' constructions of their own rules. *See id.* at 68-73 (Rehnquist, C.J., dissenting).

Most arguments in and based on *Swallows* can be winnowed down to three key points, which, in my opinion, make the case for reversal quite strong.

(1) Every tribunal — the BTA, the Tax Court, and the Fourth Circuit — that previously considered the question held that some timing requirement regarding the filing of returns is implied by the governing statute. Therefore, the only question is line-drawing: where to draw the line between permissible and impermissible tardiness.

(2) Since neither the statute itself nor its legislative history addresses where to draw the line, Congress left a gap to be filled. Line-drawing under an explicit or implicit delegation is a job for an administrative agency, not for a court. The Supreme Court has taught this regarding administrative law generally, and section 7805(a) confirms it regarding tax specifically.

(3) The bright line drawn by the regulation better advances Congress's purpose than did the uncertain timing possibilities suggested by earlier cases. The regulation was prospective, and it gives taxpayers an 18-month period. Deductions are not forfeited simply because a return is filed after its due date. They are lost only if the return is filed more than 1½ years after the due date, and even this time limit can be waived in appropriate situations. Allowing a 1½-year period is hardly draconian, excessively burdensome, or unreasonable.

Those three points being so, it is hard to see the regulation being invalidated under any standard that genuinely can be called deference, whether it be *National Muffler*, *Chevron*, or anything else. In dissent, Judge Holmes wrote: "Upholding this regulation should be almost trivially easy."[177] He was, and is, right.

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[177] 126 T.C. at 162.